PwC Middle East

Saudi Arabia publishes draft Transfer Pricing By-Laws

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In brief

On 10 December 2018, the General Authority of Zakat and Tax ("GAZT") in the Kingdom of Saudi Arabia ("KSA") published its draft Transfer Pricing By-Laws ("the draft By-Laws").

This is the first time that transfer pricing (TP) regulations of any kind have been published by the GAZT and demonstrates the KSA's commitment to introducing TP rules and implementing the Organisation of Economic Development's ("OECD") Base Erosion and Profit Shifting ("BEPS") recommendations on TP. Specifically, the draft By-Laws introduce requirements for the OECD's three-tiers of documentation, namely Master File, Local File and Country-by-Country report, as well as an annual Disclosure Form for controlled transactions.

This news alert highlights the key points which taxpayers should be aware of from the draft By-Laws. A detailed news alert will be published shortly providing more in-depth analysis of the proposed rules. A link to the draft By-Laws can be found here.

Key points

Introduction and effective date

- Article 2 of the draft By-Laws confirms that they are applicable to persons considered taxpayers in the KSA under the corporate Income Tax Law, including Permanent Establishments.

- The final version of the By-Laws will be effective from the date of their future publication, and will apply prospectively to controlled transactions to which taxpayers are a party during the fiscal year ending 31 December 2018 onwards.

- Notwithstanding this, the GAZT will have the right to request information about all controlled transactions to which the By-Laws apply retrospectively, regardless of the date of those transactions.

- The GAZT may publish guidelines on the draft By-Laws in due course, containing guidance on their interpretation, implementation, enforcement and application.

Controlled transactions

- The draft By-Laws define "controlled transactions" as those involving "Related Persons" or "Persons Under Common Control", and specifically include notional transactions with Permanent Establishments.

- "Related Persons" and "Persons Under Common Control" are widely defined in the draft By-Laws, and include within them the concept of "Effective Control" which is also broadly drafted. The effect of these terms is to potentially enable a very wide capture (or a very low bar) for transactions to be (easily) deemed controlled transactions and hence be captured by the draft By-Laws.

The Arm's Length Principle

- The definition of the arm's length principle contained within the draft By-Laws is broadly consistent with that enshrined in Article 9 paragraph 1 of the OECD's Model Tax Convention on Income and Capital.

- The GAZT expects persons engaged in controlled transactions to conduct those on an arm's length basis. Adjustments should therefore be made by taxpayers to their tax base, where those transactions are not conducted on an arm's length basis.

- If the terms, conditions or remuneration of controlled transactions do not reflect an arm's length basis, then the GAZT may either direct that the tax base be adjusted or reallocate and re-categorise revenue and expenses arising from the controlled transaction to reflect the arm's length result.

- The draft By-Laws provide for the possibility for corresponding adjustments to relieve economic double taxation.

Transfer pricing methods

- The draft By-Laws approve the use of the five OECD TP methods without prescribing a preference for the order in which they should be used.

- In line with the OECD transfer pricing guidelines, the most appropriate method should be used. Other methods can be used if the taxpayer can demonstrate that none of the approved methods provides a reliable measure of the arm's length result.

- The draft By-Laws currently define the arm's length range of results as a "range of acceptable arm's length" results without reference to a statistical measure (e.g. an inter-quartile range). The GAZT is expected to include in any future Guidelines, rules relating to the selection of a point within the arm's length range.

- Article 13 of the draft By-Laws confirms that neither taxpayers nor the GAZT may rely on comparable information which is not, or could not be made, available to either party. In addition, it is clear that foreign comparables may be used in the event that domestic (KSA) comparables are not available. However taxpayers must be able to demonstrate that those comparables are consistent with the requirements of the By-Laws and take in to account the expected impact of geographic differences and other factors (e.g. price and profitability).

Documentation

- The documentation requirements follow that outlined by the recommendations of Action 13 of the OECD's BEPS Project, namely:

    - Master File
    - Local File, and
    - Country-By-Country report (CbCR).

- In respect of CbCR, the draft By-Laws set out the circumstances in which taxpayers will need to submit and file reports and notifications to the GAZT, and state that these will need to be in the language and form that the GAZT may specify.

- In addition, Article 14 requires taxpayers to submit a "Disclosure Form of the Controlled Transactions" to the GAZT together with their annual income tax declaration within 120 days of the end of the fiscal year, containing information on the controlled transactions, the parties to the transactions, and the TP methods applied, amongst other things.

- The draft By-Laws require every taxpayer that is party to a controlled transaction to keep documentation required to confirm the conditions of the transactions are arm's length, subject to some exceptions. The documentation must be readily accessible and available for review by the tax authority at the time of submission of the Disclosure Form.

Documentation - deadlines and thresholds

Disclosure Form *– to submit within 120 days following the end of the fiscal year.*

Local file *– requirements effective 31 December 2018. To be submitted in as little as 7 days upon request by GAZT*

Master file *– requirements effective 31 December 2018. To be made available within 30 days upon request by GAZT*

CbC notification *– to submit within 120 days of the year end to which the CbC report relates*

CbC report*– to file within 12 months of the year end to which the report relates. The first* *report should be prepared for the group's fiscal year ending 31 December 2018. Applies to groups with consolidated group revenue exceeding SAR 3.2bn (c. €750m)*

Exceptions to documentation requirements

- Exceptions to the master file and local file requirements are broadly available to:
  - "natural persons"
  - taxpayers who do not enter in to controlled transactions, and
  - "small enterprises" with controlled transactions the arm's length value of which do not exceed SAR 6m (c. €1.4m)

The takeaway

Whilst still in draft, this publication is a landmark moment in the implementation of transfer pricing rules in the KSA. Given the wide application of the rules as currently drafted, taxpayers are recommended to take a detailed look at their business operations to identify transfer pricing risks and ensure they can comply with the upcoming requirements.

The GAZT has invited public comment on the draft By-Laws to be received no later than 9 January 2019.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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